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Before the
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IN THE MATTER OF:	
DIGITAL PERFORMANCE RIGHT IN SOUND RECORDINGS AND EPHEMERAL RECORDINGS	**Docket No. 2005-1 CRB DTRA**

REPLY OF THE DIGITAL MEDIA ASSOCIATION AND ITS MEMBER COMPANIES TO SOUNDEXCHANGE'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

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PRELIMINARY STATEMENT

1. SoundExchange's Proposed Findings of Fact and Conclusions of Law[1] bear out Webcasters' postulation that we are "ships passing in the night" more vividly than we ever could have imagined. In particular as it relates to the governing "hypothetical" market standards, one wonders whether the parties' ships are even in the same ocean.

2. As we demonstrate below, it is nothing short of amazing that SoundExchange could devote literally dozens of pages within its submissions to the governing standard, while never once acknowledging or citing the key passages of the Librarian's decision in CARP I (and the underlying CARP decision) determining that the hypothetical market to be replicated by this Board is a *competitive* one.

3. No amount of repetition and rhetoric can obscure this fundamental (and plainly deliberate) oversight. The stark reality is that SoundExchange has missed the boat. No volume of paper or proposed findings and citations (as to the latter, so many of which barely – if at all – support the assertions that they are stated to support) can save a rate-setting model premised on replicating the market power of the four major labels (the

[1] Throughout this document, "SX PFF" and "SX PCL" refer to SoundExchange's proposed findings of fact and conclusions of law, respectively, each submitted on December 12, 2006. Paragraph references (e.g., ¶ 356), unless otherwise specified, refer to paragraphs in SoundExchange's proposed findings and conclusions. In addition, "Joint PFFCL" refers to the jointly submitted proposed findings of fact and conclusions of law submitted by DiMA and the Radios Broadcasters on December 12, 2006; "DiMA PFFCL" referes to DiMA's proposed findings of fact and conclusions of law submitted on December 12, 2006.

"Majors"); such a model simply cannot survive scrutiny under the *real* statutory standard and hypothetical market this Board is charged to replicate.

4. The utter hypocrisy of SoundExchange in trumpeting this Board's obligation to apply the principle of *stare decisis* thus is startling. SoundExchange pays lip service to that doctrine and then fundamentally *eschews* it – both in respect of the governing competitive market standard articulated in CARP I and the findings of the prior CARPs (in the Webcasting and Pre Existing Services CARPs) in relation to the usefulness of the musical works benchmark.

5. We turn below first to a reply to what constitutes SoundExchange's Proposed Conclusions of Law and Sections I through IV of its Proposed Findings of Fact, as the latter encompass essentially legal and historical matters. Our discussion focuses on the blinders SoundExchange apparently has worn throughout the proceedings in respect of the governing competitive market standard *and* the prior precedent in respect of the musical works benchmark in cases like this. We then turn to a discussion of Sections V-XVI of SoundExchange's PFF. Webcasters have chosen not to respond "in kind" to the SoundExchange's massive approach; both DiMA's and the Services' already-submitted Joint Proposed Findings of Fact and Conclusions of Law stand in opposition to SoundExchange's submissions. Suffice it to say that the sheer "weight" of SoundExchange's assertions should not be assumed to carry any evidentiary load – as those assertions are in almost all cases irrelevant, given the true governing standard, and/or devoid of genuine support in the record.

REPLY TO SOUNDEXCHANGE'S PROPOSED CONCLUSIONS OF LAW

I. STARE DECISIS

6. DiMA wholeheartedly agrees with SoundExchange (see, e.g., SX PCL 3, 8) that it is mandatory that this Board "shall act in accordance with . . . and on the basis of . . . prior determinations and interpretations of the . . . Librarian of Congress . . .". 17 U.S.C. § 803(a)(1).

II. THE STATUTORY STANDARD: THE HYPOTHETICAL *COMPETITIVE* MARKET

7. In Section IV.A.2 of the Librarian's order in CARP I, captioned "Hypothetical Marketplace/Actual Marketplace," the Librarian makes it absolutely clear – and notes that "the parties agreed" – "that the rates [to be set] should be those that a willing buyer and a willing seller would have agreed upon in a *hypothetical* marketplace . . .". *In re Rate Setting for Digital Performance Right in Sound Recordings and Ephemeral Recordings*, No. 2000-9 CARP DTRA 1&2, 67 Fed. Reg. 45240, 45244 (July 8, 2002) (hereinafter "Lib. Order"). The prior precedent thus makes abundantly clear that this rate-setting process is not about replicating agreements that the Majors have been able to achieve in the "real world" marketplace in which the Majors operate (to use the phrase so often bandied about by SoundExchange, e.g., SX PCL ¶ 10).

8. Moreover, try as they do to avoid it, both the Librarian and the Panel below in CARP I made clear, in no uncertain terms, that the hypothetical market to be replicated by the CARP (and now this CRB) is one characterized by a "diversity among the buyers and the sellers," such that "one would expect 'a range of negotiated rates;'" and they both, accordingly, made absolutely clear that "the statutory standard [requires

the setting of] 'the rates to which, absent special circumstances, most willing buyers and willing sellers would agree' *in a competitive* marketplace." Lib. Order, 67 Fed. Reg. at 45244-45 (where the Librarian quotes and "adopts" the CARP's determination as to the above) (emphasis added).

9. It is stunning that throughout their 500+ pages, SoundExchange never *once* mentions or addresses this overarching determination. Instead, SoundExchange brazenly states that the hypothetical market to be replicated is essentially the marketplace in which the labels find themselves, whatever its state of competition; and that no attempt should be made by the Board "to construct a hypothetical market characterized by a level of competition greater than that which exists in current music markets." SX PFF 177-78.

10. SoundExchange further states that there is nothing in the DMCA or its legislative history that "suggests that Congress believed the recording industry is insufficiently competitive or that Congress was calling for rates based on a hypothetical market in which sound recording copyright owners would have less bargaining power than they currently do." SX PCL ¶ 9. Putting aside the issue that the DMCA was not a platform to engage in analyzing the *actual* market power of the Majors when they license digital services in voluntary license transactions, the Services addressed in their Joint Proposed Conclusions of Law ("Joint PCL") ¶¶ 28-49 the legislative history making it very apparent that Congress intended a hypothetical *competitive* market outcome to be replicated in these proceedings.[2]

[2] Indeed, although SoundExchange criticizes the Services and Dr. Jaffe for analogizing the willing buyer/willing seller framework to the "reasonable fee" mandate of the

11. As we discuss further below, SoundExchange's position herein – to the effect that this Board should replicate "real world" voluntary licenses entered into by the Majors as they exercise their conceded market power with interactive on-demand services (engaged in activities admittedly outside the section 114 statutory license) – flies in the face of both the above-quoted language and other significant aspects of the CARP I jurisprudence.

12. First, SoundExchange appears to have forgotten *why* the Panel and Librarian in CARP I rejected 25 of the 26 benchmark agreements proffered by RIAA. As the Librarian summarized it, "the CARP could only consider negotiated rates for the rights covered by the [section 114] statutory license that were contained in an agreement between RIAA and a Service *with comparable resources and market power*. Lib. Order, 67 Fed. Reg. at 45246 (emphasis added). The Librarian went on to explain further:

> [The CARP] evaluated the relative bargaining power of the buyers and sellers [in those 26 agreements], scrutinized the negotiating strategy of the parties, considered the timing of the agreements, . . . and evaluated the effect of a Service's immediate need for the license on the negotiated rate. Ultimately, it gave little weight to 25 of the 26 Agreements for these reasons *and because the record demonstrated that the rates in these licenses reflect above-marketplace rates due to the superior bargaining position of RIAA* or the licensee's immediate need for a license due to unique circumstances.

67 Fed. Reg. at 45248 (emphasis added). Indeed, the only one of the 26 agreements proffered by the recording industry as benchmarks in CARP I that was relied upon by the

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ASCAP/BMI "Rate Courts," the fact is that Dr. Jaffe did not make that up – it comes straight from the legislative history of the DMCA regarding the meaning of the willing buyer/willing seller, fair market value framework. See Services PFFCL ¶ II.A.3.

Panel and Librarian was the one where it was determined (rightly or wrongly) that the service had "comparable resources and market power." Lib. Order, 67 Fed. Reg. at 45245, 45248.

13. The Librarian repeatedly noted that a consequence of negotiations in which there was disproportionate "market power" or "bargaining power" in favor of the licensor (it used those terms interchangeably, see 67 Fed. Reg. 45245 vs. 45248, was that the resulting license fees were "above-market value" or "higher than marketplace rate[s]." See id. at 45245, 45248, 45249.

14. SoundExchange's current position simply cannot be reconciled with the findings and results in CARP I. Twenty-five of the recording industry's 26 proffered benchmark agreements were thrown out *precisely because* of concern that there was disproportionate market power on the side of the recording industry licensor, which led to higher prices than would ordinarily be observed in the market. Quite obviously, neither the CARP nor the Librarian was willing to allow rates to be set in CARP I that would reward the recording industry with the fruits of its disproportionate "market power" or "bargaining power"; yet SoundExchange's entire model (and legal discussion) in this case presupposes that rates should be established based on a "real world" marketplace in which the label's (particularly the Majors') market power is conceded – indeed touted – by SoundExchange and its experts.

15. The Librarian's references to "above-market" and "higher than marketplace rates" that eventuated from the exercise of the licensor's market power in CARP I is revealing for another, albeit related, reason. It begs the question: when the

Librarian states that these 25 rejected agreements yielded "above-market" or "higher than marketplace" rates, to what was he comparing those rates? The answer plainly lies in the prior determination quoted above: a *competitive* market.[3]

16. In short, the inescapable rule of law for which CARP I stands – but SoundExchange stoically ignores – is that it is not appropriate for a CARP or CRB to replicate "market rates" merely because certain sound recording licensors are able to secure such rates in "free market" negotiations. To the contrary, the law of CARP I is clear: when the proffered agreements reflect disproportionate market power, they *cannot* be relied upon as benchmarks.[4]

17. Moreover, as the Librarian and Panel found in CARP I, and as is set forth explicitly in 17 U.S.C. § 114(f)2)(B), the only voluntary agreements to be considered by the Board in establishing rates and terms are those "for comparable types" of services

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[3] It is noteworthy that one agreement thrown out as above-market was at a royalty rate of 11% of revenues. See Report of the Copyright Arbitration Royalty Panel, In the Matter of Rate Setting for Digital Performance Right in Sound Recordings and Ephemeral Recordings, February 20, 2002, at 56-57 (The "CARP Report"). Astonishingly, SoundExchange now seeks almost three times that CARP-determined supra-competitive rate.

[4] SoundExchange has suggested that the CARP I decision relates only to the market power of RIAA, and that since the agreements upon which it relies in the instant case are individual deals secured by the Majors, the discussion above is of no (or less) force. That is untrue. The Librarian (and Panel below) plainly focused on disproportionate market power as a *concept* that infects any ability to rely on a given agreement as a benchmark, and did not limit itself to consideration of RIAA as an entity. Indeed, the Librarian and Panel ultimately relied on an RIAA agreement (with Yahoo!) as a benchmark, precisely because they did not find a disproportion in market power as between those parties. (We note that the RIAA negotiations with Yahoo! that were the subject of CARP I occurred before Yahoo! acquired the allegedly "interactive" LaunchCast service, and thus did not occur while there were pending claims that Yahoo! was operating an infringing, non-DMCA compliant service.)

entered into under "comparable circumstances." Lib. Order, 67 Fed. Reg. at 45245. The Services have demonstrated in this case that, as a matter of fact, the benchmark agreements proffered by SoundExchange and Dr. Pelcovits herein are decidedly not with "comparable services;" rather, they are with non-statutory, on-demand subscription services with entirely different functionality than DMCA-compliant webcasters and which operate under different economic circumstances (including an absolute need to secure a license from each of the Majors lest they have no business). See Services PFFCL Section III.B[5]

18. SoundExchange again appears to shield itself with blinders regarding the determination of the Panel and Librarian in CARP I as to the lack of basis for relying on such agreements with non-DMCA compliant services in these proceedings. Responding to the webcasters' evidence about how these non-DMCA compliant services were not "comparable" to them or in "comparable circumstances," the Panel rejected some 115 agreements offered as corroborative evidence by RIAA between individual labels and such services, including some with the very same on-demand services that serve as SoundExchange's benchmark in the instant proceedings. CARP Report at 54-57. See also 67 Fed. Reg. at 45257.

19. It is the utmost of hubris for SoundExchange repeatedly to invoke the principle of *stare decisis* in reference to the CARP I and Librarian decisions, and then to

[5] In contrast, and directly contrary to SX PFF ¶ 13, webcasters operating under the programming restrictions of the DMCA (which do not and cannot promise the "music you want when you want it") can survive for certain periods of time without the catalogue of even the largest Major, Universal Music Group. See Roback WDT ¶ 3-7; SX PFF 554.

ignore the entire force of those decisions insofar as they relate to the rejection both of 25 of the 26 agreements proffered by RIAA as benchmarks and the 115 label agreements with "noncomparable" services operating outside the section 114 statutory license.

20. Apparently with nothing affirmative to say about the governing hypothetical "competitive" market standard, SoundExchange reverts to setting up straw men to knock down. For example, SoundExchange asserts that Dr. Jaffe and the Services dispute who the "willing sellers" are in the hypothetical market. See SX PCL ¶¶ 16 et seq. There is no such dispute. The Services agree that the willing sellers are record companies licensing their music catalogs on a catalog-wide (or blanket) basis. The difference is that the Services posit – consistent with CARP I precedent ignored by SoundExchange – that those willing sellers are licensing in a hypothetical *competitive* market, i.e., one in which there are multiple buyers and multiple sellers offering music on a basis such that buyers have some ability to substitute as between competing sellers (which even SoundExchange's expert agrees is the hallmark of a competitive market – see Services PFFCL ¶ 39).[6]

[6] As part of this straw man argument, SoundExchange asserts that certain manifestations of a hypothetical competitive market were rejected in CARP I. See, e.g., SX PCL ¶ 14 (referring to a "hypoth[etical] market in which there are millions of copyright owners licensing one or only a very small number of copyrighted sound recordings"), PCL ¶ 19 (referring to a "model reflecting nearly 'perfect competition'"). But these are only two constructs of a hypothetical competitive market, neither of which are urged specifically by Webcasters herein. And the fact that those two particular manifestations of a competitive market may have been questioned or rejected before does not *in any respect* diminish the unambiguous determinations of the Panel and Librarian in CARP I that the hypothetical market to be replicated by the CRB is a "competitive" one, as discussed above.

21. This is precisely the type of competitive market of which the Librarian spoke, comprised of a "diversity among the buyers and the sellers" out of which "one would expect 'a range of negotiated rates'" to emerge. 67 F.R.D. at 45244. The SoundExchange-proffered benchmark agreements herein, in stark contrast, reflect utterly no "diversity," as they are the product of the four Majors using their substantial market power in the on-demand licensing marketplace to extract supracompetitive rates that are effectively all the same due to the prevalence of "most favored seller" clauses.

22. SoundExchange's argument here is no different than its attempt to rely on a small slice of the "demand curve" in CARP I, consisting of entities that had comparatively little bargaining power vis-a-vis RIAA and/or unique or immediate needs that motivated them to pay "above-market" prices. It is not enough to say that the benchmark agreements were "free market" – so too is the "soda on the beach" purchaser engaging in a "free market" act to pay $5 for a can of soda that costs one-tenth of that in a supermarket. But that slice of the demand curve does not reflect "'the rates to which, absent special circumstances, *most* willing buyers and willing sellers would agree' in a competitive marketplace" – and *that* is the governing standard. Lib. Order, 67 Fed. Reg. at 45244-45 (emphasis added).

23. Another of SoundExchange's straw men is the suggestion that only *it* has come forward with a benchmark based on "real world" marketplace deals. Over and again, SoundExchange accuses the Services of having come forward only with a "hypothetical world" construct born out of an economist's musings. See, e.g., SX PCL ¶ 26. But the reality is that the Services' musical works-based model for rate-

setting is no less based on "real world," actual deals than SoundExchange's model. It is based on *actual* agreements negotiated by the Services with the suppliers of musical work performance licenses (ASCAP, BMI and SESAC).

24. Indeed, the benchmark PRO agreements underlying the Services' model involve the identical willing buyers, and sellers of blanket licenses standing economically in the virtually identical shoes as the willing sellers in the hypothetical competitive market at issue herein. And, decidedly unlike SoundExchange's proffered benchmark agreements, the musical work model is based on a competitive market ensured by the existence of the ASCAP/BMI rate courts.[7]

25. SoundExchange also asserts the straw man that the Services' seek the establishment of a "reasonable" rate based on "policy considerations" instead of a "market"-based, willing buyer/willing seller rate. See SX PCL ¶¶ 39-41. That is simply untrue. As noted above, however, the legislative history and prior jurisprudence supports the proposition that the willing buyer/willing seller standard invokes the definition of a hypothetical *competitive* market rate (which has been construed by the ASCAP/BMI rate courts to be tantamount to a "reasonable" rate).

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[7] SoundExchange seeks to make much of the "different rights" involved in the musical works model. However, *neither* SoundExchange's nor the Services' benchmark agreements concern the same rights at issue herein. On-demand sound recording rights, as noted above, are not at all comparable to the non-interactive webcast rights covered by the DMCA statutory license. And no amount of SoundExchange saying that on-demand services are "closely related" or "extremely similar" makes that so. Meanwhile, unlike SoundExchange's proffered benchmarks, the uses of the music in question are identical as between the Services' use of sound recordings and their use of the musical works embedded in the identical webcast performances made by webcasters.

26. Finally, SoundExchange injects the "pity" straw man, suggesting the Services are arguing that the law should be construed and rates set to "preserve the business of every webcaster." SX PCL ¶ 11. To the contrary, all the Services seek is a rate to which "most willing buyers and willing sellers would agree in a competitive marketplace" – not a rate based on what some very different music services have been willing (or effectively forced) to pay in a market where the Majors have substantial market power.

III. STARE DECISIS AND THE MUSICAL WORKS MODEL

27. SoundExchange argues that the Webcasters are "relitigating" a musical works-based model that was tried and rejected before, and which is precluded by *stare decisis*. It is wrong on the facts and the law.

28. First, the model advanced by Webcasters herein solves certain perceived infirmities in the musical works-based model advanced in CARP I. The Panel in CARP I was troubled by the fact that the underlying musical works fees that were being relied upon in CARP I were not those paid by the Webcasters themselves, but by over-the-air radio broadcasters; and its concern was compounded by the "string of assumptions" and aberrations in application that ensued from that fact. See Lib. Order, 67 Fed. Reg. at 45246. Those problems have been solved insofar as, in the instant case, the model is based on what the *identical* Webcasters actually pay for musical work licenses to ASCAP, BMI and SESAC.

29. SoundExchange nonetheless suggests that the underlying factual premise of the musical works benchmark – i.e., that webcast performances of sound recordings

have no greater economic or market value than webcast performances of the musical works embedded in those same recordings – was rejected in CARP I. That is incorrect. As the Panel stated: "As to the precise relative value in performance rights in sound recordings vis-à-vis musical works, we render no opinion." CARP Panel Dec. at 41; see also Lib. Order, 67 Fed. Reg. at 45250.

30. Indeed, instructive prior precedent on this score comes from the 1998 CARP decision in the Pre-Existing Services case. Unequivocally, the Librarian in his 1998 decision in the DCR case *in fact* utilized the licensee's musical work fees as a relevant benchmark for setting its digital sound recording performance fees. Moreover, the Librarian found that the evidence in the case did *not* support the conclusion, urged by the RIAA, that the value of the sound recording performance exceeded the value of the musical work performance. And that conclusion has *nothing to do* with the different rate setting standard associated with pre-existing services.

31. The subject of the potential applicability of the musical works benchmark then came up in pre-hearing motion practice before the trial in CARP I. The Librarian there held, in its July 18, 2001 Order, that "the musical works fee benchmark identified in a previous rate adjustment proceeding as the upper limit on the value of the performance of a sound recording *may or may not* be adopted as the outer boundary of the 'zone of reasonableness' in this proceeding." See Lib. Order, 67 Fed. Reg. at 45247.

32. SoundExchange implies that the CARP and Librarian made a final determination rejecting for all time the musical works benchmark for sound recording rate-setting purposes in CARP I. But it is once again incorrect. The CARP Panel chose

not to adopt the musical works model as a benchmark preferring, instead, to root its determination in RIAA's marketplace agreement with one of the 26 webcaster licensees with whom RIAA had contracted. Nevertheless, the Librarian made clear that, while the Panel was not *obligated* to do so, "the Panel could have utilized Dr. Jaffe's model in making its decision" and merely adjusted for whatever assumptions needed to be accounted for "to perform the conversion of the rate for the public performance of a musical work in an analog environment into a comparable rate for the public performance of a sound recording in a digital format." Id.

IV. OTHER LEGAL ISSUES

1. Gross Revenue Definition

33. Webcasters' proposed definition of gross revenues finds much more support in the law than does SoundExchange's. First, as the Librarian found in CARP I, "[a]s a general principle, terms pertaining to a statutory license must be defined with specificity." As such, as even SoundExchange expert Dr. Pelcovits conceded, a definition of revenue that included directly "or indirectly" related revenues – as sought by SoundExchanges --- is decidedly too unspecific to adopt.

34. Second, the existing definition of revenue for subscription webcasters also is a relevant guide (37 C.F.R. § 262.2(m)); and it, too, far more closely resembles the Webcaster proposal herein than SoundExchange's expansive version.

35. As a final word on the revenue-definition issue, we note that this is the type of issue often put out for notice and comment, so that the process of arriving at an appropriate definition can be interactive and the result one that all parties concerned

understand. The Judge may wish to have a separate hearing devoted to definitional issues of this nature.

REPLY TO SOUNDEXCHANGE'S PROPOSED FINDINGS OF FACT

I-IV. REPLY TO SOUNDEXCHANGE'S PROPOSED FINDINGS OF FACT SECTIONS I-IV

36. Webcasters will rest on their initial and joint submissions as to these sections of the SX PPF, except as to underscore the following as regards Section I.C of the SX PFF.

37. The series of agreements entered into by RIAA in 2003 with the DiMA webcasters, the SDARS services, and the Preexisting Services fundamentally undermine the SoundExchange positions herein. In each case, without any compulsion whatsoever, the RIAA and its member labels voluntarily agreed to royalty structures that were either lump sum (SDARS), percent-of-revenue with no usage minimum (Preexisting Services) or, at the option of the licensee, a percent-of-revenue vs. usage metric. Further, the effective (equivalent) or stated percentage-of-revenue rates in respect of each of those agreements was in the range of about 5% (SDARS estimate from public report) to 7% (Preexisting Services) to 10.9% (webcaster option). There is simply no warrant for SoundExchange to alter so drastically the structure and amount of royalties it receives from webcasters as contrasted against these voluntary arrangements.

V. THE BENCHMARKS

38. DiMA hereby refers to and incorporates the Reply of the Radio Broadcasters to Section V of the SX PFF.

B. Musical Works – Dr. Jaffe's Benchmark

39. In its Joint PFFCL with the Radio Broadcasters, DiMA discussed at length the reasons spelled out by Dr. Jaffe as to why both sound recording owners and musical works owners would, in the hypothetical competitive market, both approach the negotiation with a webcaster from the standpoint that its costs of creating the underlying intellectual property are sunk.

40. Without repeating all the reasons Dr. Jaffe takes that position, DiMA pauses for a moment here to reiterate one key point. SoundExchange has raised the argument (both with Dr. Jaffe at trial and in its PFFCL at ¶¶ 462-469) that costs for recordings that are made in the future cannot, by definition, be "sunk." SoundExchange goes on to detail the percentage of industry income that flows from recently produced recordings. Id. at 467. This observation, while superficially accurate, blurs a crucial distinction between at least three points in time: (1) the present, at which point the Judges will determine the royalty rate; (2) that time in the future at which a record company decides whether or not to invest in a new sound recording, and (3) that time in the future when said record company decides whether or not to license that new recording for public performance.

41. The job of the Judges is to replicate the rate that a willing-buyer-and-willing seller would agree to when *negotiating performance rights in a competitive market* – i.e., the third of the three time frames mentioned above. As such, the fact that the Judges are setting the rate now, before future sound recordings have been created and costs "sunk," is irrelevant – the goal here is to come up with a rate that replicates what *would happen* in hypothetical negotiations, not a negotiation in the present for the

licensing of future sound recordings. And those hypothetical negotiations happen *after* the creation of the sound recording being licensed. In other words, the costs of the new sound recordings *would in fact be sunk* at the time of the negotiations which the Judges are charged with replicating. The record is clear, as explained at length in the Joint PFFCL, that no new or incremental costs flow from the decision to license the performance itself – all costs *would in fact be sunk* at that point.

42. Similarly, the decision of record companies to invest in future sound recordings in the first instance, and the costs involved in doing so, are also irrelevant to the decision of whether or not to *license* for *subsequent public performance*: the record again is clear that that the decision to create and market new sound recordings is completely unaffected by the presence of webcasting or the royalties it generates. As Dr. Jaffe testified, it is unrealistic to expect that to change, no matter what the royalty rate, in the next five years.

VI. THE DIVISION OF THE AVAILABLE SURPLUS BETWEEN SOUND RECORDING OWNERS AND USERS OF THOSE SOUND RECORDINGS

43. DiMA hereby refers to and incorporates the Reply of the Radio Broadcasters to Section VI of the SX PFF.

VII. IMPROVEMENTS IN THE MARKET SINCE 2002

A. SoundExchange's Projections of Growth Do Not Justify a Higher Royalty Rate

44. As an initial matter, it should be remembered that record companies will share in the growth SoundExchange discusses in Section VII through the percentage-of-revenue royalty that DiMA recommends when webcasters pay on that basis: i.e., if a

webcaster's revenues grow 100%, the royalty will grow 100%. Only if one accepted Professor Brynjolfsson's unfounded "surplus" argument might this become relevant; the merits of that argument (or lack thereof) have been dealt with elsewhere. See Joint PFF at Section III.C.1-2; Radio Broadcasters' Reply at Section _. If Professor Brynjolfsson's model properly is rejected, there simply is no reason why the growth in this industry (which, in many respects, DiMA does not dispute) should be a factor in determining the rate – although it certainly will play a major role in determining the royalties that are payable. If anything, such growth should give the Judges even more confidence in assigning a royalty in the competitive percentage range outlined by Dr. Jaffe.

B. SoundExchange's Projections of Revenue Growth Fail to Account For Corresponding Costs

1. Webcaster Revenues Are In Fact Dwarfed By Related Costs

45. In ¶ 709, SoundExchange trumpets the fact that Live365 had "touched on profitability" for a few months. To begin, that admission in itself provides a sobering counterpoint to the rosy picture painted by Dr. Brynjolfsson. In fact, it is only by focusing almost exclusively on webcasters' revenues and essentially ignoring their costs – in particular the crippling sound-recording royalty costs – that SoundExchange can muster its arguments. Paragraph 709 is unfortunately just one example of this approach; remarkably, in the entire 64 pages and 208 paragraphs that comprise section VII of SoundExchange's proposed findings of fact, the only costs discussed are bandwidth costs.

46. As Mr. Lam's testimony made clear, Live365's alleged "profitability" exists only when one looks merely at Live365's "EBITDA" figures (earnings before

interest, taxes, depreciation, and amortization). When these "capital expenditure" expenses are included, he testified, one can see that Live365 has lost, and continues to lose, millions. 11/6/06 Tr. (closed) 92:22-93:6 (Lam), 11/06/06 Tr. (open) 154:14-159:8 (Lam); SX Ex. 023 DR. Moreover, as he pointed out, even the positive EBITDA figure occurred only because Live365 lost a number of key employees and thus shed their salaries. 11/6/06 (open) 116:12-117:10 (Lam).[8]

47. In ¶¶ 730-31, Live365 advertising revenue growth is once again cited with no reference to costs. For example, SX Trial Ex. 141 (SoundExchange's source of the data) reveals that Live365 paid [redacted] in commissions to Ronning-Lipset and Value Click to earn the [redacted] reported by SoundExchange – about [redacted]. It also reveals that advertising revenues dropped from May 2006 to September 2006 – from [redacted] to [redacted] – a 33% drop.

48. As SoundExchange notes, Ex. SX 23 DR reveals that Live365 earned [redacted] per listener hour in revenues for fiscal year 2005; what SoundExchange does not report, but exhibit SX 23 DR does, is that Live365's costs (before capital expenditures) equaled [redacted] per hour – and that the sound-recording royalty portion of this (without the gargantuan increases sought here by SoundExchange) was the single greatest cost.

[8] At ¶¶ 850-52, SoundExchange attacks Mr. Porter's credibility by pointing out that Live365 hasn't been paying interest on its convertible debt. Review of the transcript however, reveals that all Mr. Porter testified to was that Live365's EBITDA losses would be even greater *if* that interest were added in. The fact that Mr. Lam pointed out that such interest has not been paid, while true, does not make Mr. Porter's testimony "misleading" in any way.

49. Finally, as explained in DiMA and Radio Broadcasters Joint PFFCL at ¶ 225, these revenue figures include a category of income that is in fact a cost of webcasting that Live365 passes along to its hobbyist and broadcaster customers because it can't afford to cover that cost. Lam WRT ¶ 4. As Mr. Lam explained, although this income shows up as revenue on Live365's books, it is not revenue generated by webcast *listening* (i.e., revenue paid by consumers to listen to sound recordings, or revenue paid by advertisers to have access to those consumers who are listening), but rather a cost that is passed through to the broadcasters for use or "rental" of Live365 infrastructure (servers, storage, bandwidth costs, etc.) that broadcasters otherwise would have to supply themselves. Lam WRT ¶ 4. 11/6/06 Tr. 76:18-80:8 (Lam).[9]

50. In ¶ 752, SoundExchange discusses the alleged "improvement in economic surplus per listener hour" enjoyed by Live365.com (based on Brynjolfsson AWDT at 4 (Table 1)). The chutzpah of this statement is nothing short of amazing: This so-called "improvement" in "surplus" is in fact really a decrease in loss-per-hour. Only through such double-speak can SoundExchange turn the fact that the service is losing money hand over fist into a justification for raising the royalty rate even further. For example, in FY2002, Dr. Brynjolfsson's calculations reveal revenues of [redacted] per

[9] SoundExchange's response to this criticism, at ¶ 868, is not credible and frankly makes no sense. It suggests that it chose to include such revenue because it could not determine how much of Live365's streaming costs were "covered" by those broadcaster fees. As pointed out in the Joint PFFCL at ¶ 225 and fn. 25, those broadcaster fees *are costs themselves* that are simply passed through to Live365 broadcasters. If one wanted to compare Live365's "true" revenues with its streaming costs (which SoundExchange nowhere attempts), one could simply reduce both Live365's revenues and costs by the amount of these pass-through broadcaster fees.

hour, but much higher combined costs of [redacted] per hour. Only in 2005 do the costs per hour appear to fall below the revenues per hour ([redacted] revenue vs. [redacted] in combined costs). Brynjolfsson AWDT at 4 (Table 1). This last figure for 2005 is quite misleading, however, because careful review of Dr. Brynjolfsson's numbers and some grade-school addition reveal that his costs figures exclude the sound recording performance royalty – Live365's biggest 2005 expense. See SX Exhibit 023 DR. With the sound recording royalties properly added in, the actual cost per hour was [redacted], much more than revenue per hour.[10]

51. In ¶ 725, SoundExchange breathlessly reports that Yahoo!'s in-stream advertising revenues increased 63.8% per quarter from the beginning of 2005 to the last quarter of that year. What it fails to acknowledge, however, is that the revenue-per-hour for each quarter ([redacted]) are both well below the CARP royalty rate of $.0117 per hour! (It should also be noted that Yahoo!'s comments about "advertising revenue" doubling in 2006, reported in ¶ 725 of the SX PFFCL, was specifically limited to in-stream audio advertising and player sponsorships/takeovers, not all advertising, as SoundExchange's language might suggest. See 6/21/06 Tr. 255:4-20 (Roback).

[10] The real figure can be easily calculated from SX 023 DR by adding "Total COS" for 2005 ([redacted] + Total Expenses ([redacted]) + CAPEX ([redacted] subtracting the "Others" category ([redacted]) (because Professor Brynjolfsson nets this cost out of revenues), and then dividing by the TLH (total listening hour) figure of [redacted] Professor Brynjolfsson's combined cost figure for 2005 ([redacted]) is achieved by adding the lines on SX 023 DR for "Bandwidth" ([redacted]), "Colo facility" ([redacted]), Total Expenses ([redacted]) + CAPEX [redacted]), and then dividing by the TLH ([redacted]). In other words, he leaves out (without explanation) the costs for "DSRP" (the sound recording royalty), "ASCAP, BMI, SESAC" (musical works royalties), and "Thomson MP3."

52. SoundExchange moves on to discuss subscription services in ¶¶ 765-68. Once again, there is no reference whatsoever to subscription service costs – just a statement that these services are "currently profitable" and quotations from Yahoo! indicating they earn a gross margin of [redacted] on their subscription product. Of course SoundExchange doesn't mention the word "gross" – despite the fact that Mr. Roback made clear that such margins exist only when one counts just variable costs like royalties and bandwidth – i.e., not counting for fixed costs, capital expenditures, overhead, and the like. 6/21/06 Tr. 182:11-183:13 (Roback); see also SX PFF ¶ 833 (similarly referring to "profit margin" without clarification).

53. As the case of Live365 makes clear, its Total Cost of Sales ([redacted]) and Total Expenses ([redacted]) for 2005, see SX Exhibit 023 DR, dwarf the subscription revenues reported by SoundExchange in ¶ 765; moreover, its number of subscribers has been dropping since April of 2006. SX Trial Ex. 141. See also 6/19/06 Tr. 126:6-12 (Porter) (explaining that the subscription business for Live365 has been "profitable" only "on a marginal basis" because the royalty rate is calculated as percentage of revenue); id. at 131:1-6, 133:16-134:5 (noting that subscription streaming represents only 10% of Live365 streaming hours, and that despite margins earned on the subscription product, SoundExchange royalties overall represented 42% of Live365 revenues for 2005).

2. SoundExchanges's Use of Future Revenues to Justify an Increase in the Royalty Rate is Circular and Ignores the Role of the Royalty Rate in Determining Future Growth

54. In ¶ 687, SoundExchange quotes Dr. Brynjolfsson's suggestion that participants in the current proceeding have been willing buyers at the current CARP rate, and that webcasters would remain "willing buyers" even at a "significantly increased" rate. As discussed in ¶ 231 of the Joint PFFCL, testimony from the webcasters suggests directly the opposite conclusion. Mr. Roback, for example, testified that Yahoo! will likely exit the business if the rate increases. Roback WRT ¶ 11; 11/9/06 Tr. 49:1-13 (Roback); see also 6/20/06 Tr. 43:18-44:3 (Lam) (same).

55. This dynamic points to a more significant problem with Professor Bynjolfsson's reasoning. Namely, he uses the alleged tremendous growth potential of the webcasting industry as justification for an increased royalty rate – but fails to recognize that the royalty rate he proposes would cripple the industry and stunt the very growth on which his proposed increase relies. As Mr. Roback noted during his rebuttal testimony, the projections on which Dr. Brynjolfsson relied (besides being overinclusive and unreliable for a variety of reasons detailed by Mr. Roback) would likely be lower even if the royalty rate remains the same, much less if it is tripled as SoundExchange requests. Roback WRT ¶ 16(b); 11/9/06 Tr. 85:2-86:3 (Roback)

56. By contrast, the testimony of Eric Ronning shows how the same dynamic can work in reverse – namely, that a *lower* royalty rate will allow webcasters to market their services and increase their streaming hours dramatically (thus gaining more "eyeballs"), which in turn will allow them to keep the ads-per-hour to a reasonable number without having to sacrifice sold impressions, which can increase CPM's relative

to network national radio and grow the pool of advertising revenue. See 6/26/00 Tr. 179:19-185:21.

3. SoundExchange's Advertising Growth Figures Fail to Account For Commissions Paid to Ad Rep Firms

57. In ¶ 669, SoundExchange notes the increase in advertising revenues for Live365 once it signed Ronning-Lipset to broker its in-stream advertising inventory – in particular the "doubling" of revenues in the fourth quarter of 2005. As Mr. Lam of Live365 explained in his testimony, the revenues "doubled" because the base against which they were measured (those ads Live365 had managed to sell on its own) was de minimis. Moreover, the [redacted] in revenue failed to account for the approximately [redacted] in commissions taken by Ronning-Lipset (meaning Live365 netted more in range of [redacted]), or the additional fee charged by Aribitron to monitor listening on the service and qualify it for inclusion in the Ronning-Lipset netowork. See Ronning WDT ¶¶ 13-14, 17; 11/6/06 Tr. 98:22-99:13 (Lam).

58. A similar issue infects ¶ 722, where SoundExchange reports that Ronning-Lipset sold $3.5 million in in-stream audio advertisements in 2005. After commissions are figured, the services in the Ronning-Lipset network would only have received about $2.25 million. See Ronning WDT ¶¶ 17; 6/26/06 Tr. 227:11-22 (Ronning) (demonstrating calculation of net income after deducting 15 percent and then 25 percent for relevant commissions). As for the "dramatic increases" in CPM's between 2004 and 2005 reported by SoundExchange in ¶ 722, Mr. Ronning testified that the growth has not been near as great in 2006, rising only from $3.40 to $3.60 gross. 6/26/06 Tr. 216:18-217:2 (Ronning).

C. SoundExchange's Projections of Growth Are Frequently Misleading

59. In ¶ 685, SoundExchange discusses the entry into the market of smaller webcasters like AccuRadio and RadioIO – suggesting that they are doing so "at the current royalty rate." See SX PFFCL VII.B (section heading). This sentiment was echoed in the rebuttal testimony of Mr. Griffin, who suggested that webcasters' complaints about the prior CARP royalty rate were "exaggerated," and that they were "thriving" at that rate. See Griffin WRT at 3. Of course, as Mr. Griffin admitted during his cross-examination, certain of the webcasters he quoted are not even paying at the prior CARP rate, but are instead paying under the terms of a settlement negotiated under the Small Webcasters Settlement Act of 2002. See 11/22/06 Tr. 107:14-108:21, 112:7-11. As Mr. Griffin also acknowledged, small webcasters like AccuRadio pay not at the CARP rate, but under a negotiated percentage of revenue metric. Id.

60. In ¶¶ 733 and 809, SoundExchange once again resuscitates its claims about AOL's "estimation" of its potential ad revenues from adding in-stream audio advertisements to its broadband product. Ms. Winston of AOL has testified repeatedly about how SoundExchange (and particularly Dr. Brynolfsson) have misinterpreted this data, which was a "holding capacity analysis" that used an unrealistic sell-out figure of 100%. (This was explained at length in Ms. Winston's rebuttal testimony at ¶¶ 7-8, and the Joint PFFCL at ¶ 226.) Moreover, Ms. Winston's testimony also reveals that AOL's revenues since the addition of in-stream advertising in its broadband product have

increased about [redacted] – a far cry from the $1 million presented by SoundExchange in paragraph 733.[11]

61. SoundExchange likewise ignores clear evidence on the record that webcasters are in fact limiting usage because of the excessive royalty costs. See, e.g., Winston WDT ¶ 24-27. At paragraph ¶ 864, SoundExchange attempts to throw water on these claims by suggesting that AOL limited usage on only one of its radio products, and then retired that product in favor of one without any such cap. As Ms. Winston testified, however, the product where listening was "capped" (Radio@Netscape), was by far AOL's most popular product. 6/15/06 Tr. 65:12-66:12 (Winston). In addition, when AOL capped that product in early 2004, it took a massive hit in listenership from which, at the time of Ms. Winston's testimony in June of 2005, it had just recovered. Winston WDT ¶ 25; 6/15/06 Tr. 77-78 (Winston); indeed, Ms. Winston made clear that AOL is prepared to institute a similar cap on the new AOL radio product depending on the outcome of this proceeding. Id. at 77:12-78:6.

D. SoundExchange Misleadingly Presents Evidence Dealing with Non-Webcasting Services and Revenues as Relating to Webcasting

62. SoundExchange accuses webcasters of bad faith in failing to properly attribute revenues to webcasting. See, e.g., SX PFF ¶ 810 (claiming webcasters

[11] Although this [redacted] increase in AOL's in-stream audio advertising revenues represents a doubling (as SoundExchange reports at PFF ¶ 808), Ms. Winston testified that the increase came about largely because AOL now enjoys a larger share of the Ronning-Lipset network (i.e., its increase comes at the expense of other services' decrease), and because of the general increase in overall sales that Ronning Lipset has achieved for 2006. 11/6/06 Tr. 43:2-44:5 (Winston). There is no evidence that advertising revenues industry-wide (the metric that ultimately matters from SoundExchange's perspective) increased because of this added inventory.

"artificially manipulate" their webcasting revenues). As noted by Mr. Roback, WRT testimony¶ 10, this allegation is unfounded and irrelevant when there is currently no percentage-of-revenue royalty metric. The question is what revenues, going forward, *should* be part of the revenue base. Furthermore, those who in live in glass houses should not thrown stones. In their zest to make much of the vast revenues to be earned via webcasting, SoundExchange repeatedly casts statements and financial figures that are clearly about portals or non-webcasting music services as if they somehow deal with webcasting.

63. In ¶ 660, for example, SoundExchange (selectively) quotes David Goldberg of Yahoo! and suggests that he is claiming that webcasting will replace broadcast radio and CDs by 2015. Goldberg in fact says nothing of the sort; although he does say he believes that webcasting will replace broadcast radio, he says that CD's will be replaced by not by webcasting, but by "on-demand subscription services." For SoundExchange to twist Goldberg's words about "digital music services" of various types into a suggestion that webcasting will replace CDs is dishonest and misleading. See Griffin WDT at 59 and fn. 60.

64. In ¶ 726, SoundExchange likewise quotes a management presentation given by Mr. Roback where he reports a growth rate of advertising for all of Yahoo! Music – a fact that says nothing about webcasting-related advertising revenues (and likely reflects the well known fact that video ads sell at a much higher rate, see Roback WRT ¶ 13(c)). Similarly, in ¶ 778, SoundExchange quotes a Yahoo! corporate report indicating the revenue per user per month for the Yahoo! portal – a fact that says nothing

about the per-user value to Yahoo! Music, let alone its webcasting service. See also ¶ 780 (using statement about Yahoo! Music in general to support argument that "webcasting services" are "sticky").

65. In Section VII.C.4, beginning at ¶ 748, SoundExchange rehashes the Amended Written Direct Testimony of Professor Brynjolfsson, and in particular his misallocation of site-wide banner advertising revenue from all of Yahoo! Music to LAUNCHast, Yahoo!'s webcasting product. And at ¶ 829-830, SoundExchange once again details the revenue projections for all of Yahoo! Music that Dr. Brynjolfsson similarly used. DiMA will not reiterate here the problems with Dr. Brynjolfsson's analysis and use of these documents, which were discussed at length in the Joint PFFCL at ¶¶ 221-224, 227, and also in Mr. Roback's Written Rebuttal Testimony, see ¶¶ 13, and oral testimony, see 11/9/06 Tr. 54:8-55:20, 176:19-177:2 (Roback).

66. In a related argument, SoundExchange faults webcasters – Yahoo! in particular – for failing to attribute revenues earned on its homepage or other non-webcasting pages to webcasting. See SX PFF ¶ 811-815. DiMA's PFFCL addressed this issue in the context of the definition of revenue that accompanies its fee proposal. See DiMA PFFCL Section V.C. As DiMA noted, there is a fundamental problem with any proposal to sweep in all such revenue: namely, the inability to determine whether a home page visitor is already a webcasting "user" that is passing through the home page on the way to the webcasting service, or whether the home page visitor has visited the portal for some other reason not related to webcasting and then been enticed to click a link to try the webcasting service. In the latter scenario – which is much more likely in

light of the massive traffic to portal home pages as compared to music-section pages, see 11/7/06 Tr. 10:14-11:18 (Fancher) – AOL Radio and Lauchcast (not coincidentally the two largest webcasters in the market) enjoy spectacular increases in royalty-bearing listening that the labels share in. SoundExchange, of course, glosses over the distinction, and refers repeatedly to the "users" who garner revenue for Yahoo! outside the webcasting service – while failing to acknowledge that benefits flow the other way too, and that many listeners only become "users" thanks to the fact that they were users of Yahoo! or AOL first. See, e.g., 6/16/06 Tr. 189:2-12 (Winston).

67. SoundExchange commits a similar oversight in ¶ 816, where it faults Yahoo! for not attributing to webcasting revenue from other Yahoo! services that have been advertised on . First, such "house ads," as they are called, are run only when there is unsold inventory – they never replace advertisements that could be sold or advertising revenue that could be earned. 6/21/06 Tr. 357:14-359:7 (Roback). More important, SoundExchange's position overlooks the fact that Yahoo! Music and LAUNCHcast are beneficiaries of such ads run on other parts of the Yahoo! network. Id. Again, SoundExchange fails to recognize the degree to which listening (and hence sound recording royalty payments) is increased by virtue of LAUNCHcast's affiliation with the Yahoo! network, and focuses only on benefits that flow in the other direction.

E. Webcasters Do Not Use Nonsubscription Products As "Loss-Leaders" for More Lucrative Businesses

68. In its Joint PFFCL, DiMA pointed out the fallacy in Professor Brynjolfsson's contention that Yahoo! uses its free LAUNCHcast service to drive subscriptions to its LAUNCHcast Plus product (this contention is repeated virtually

word-for-word by SoundExchange in ¶ 824). As Mr. Roback has testified, Yahoo! "caps" heavy listening on nonsubscription LAUNCHcast and attempts to move listeners to the subscription product because the royalty cost of the additional listening hours is not covered by advertising revenue, especially when many of the ads in those additional listening hours go unsold. Roback WRT ¶ 15; 11/9/06 Tr. 81:8-83:8 (Roback). (He also points out that the subscription product is also a royalty-bearing product where SoundExchange is paid on a percentage of subscription revenue. Id.)

69. SoundExchange, in ¶ 797, reiterates the argument, this time with respect to a quote from Mr. Roback's deposition testimony that free LAUNCHcast represent the "primary marketing" for subscription LAUNCHcast Plus – and that the latter product would probably be retired if the free product were discontinued. The point, when taken in proper context, is that LAUNCHcast Plus, a relatively small part of Yahoo!'s business, is essentially a byproduct of Yahoo! Music's need to cap listening on its free product – and one that therefore might become expendable if Yahoo!'s main webcasting product, the free service, went away. SoundExchange reverses the dynamic, suggesting that the free service is merely a "marketing tool for the subscription service," as if what were "so important" to Yahoo! is driving subscriptions. PFF ¶ 797. But as Mr. Roback has testified repeatedly, Yahoo! clearly views the free, ad-supported product as the future of the business and the best opportunity; to the extent it drives subscriptions it does so to avoid costs. Roback WRT ¶ 15.

70. In ¶¶ 807-808, SoundExchange also once again presents the argument – thoroughly rebutted by Ms. Winston in her written rebuttal testimony – that AOL's

failure to run ads on its XM stations or in its broadband stations somehow represents an intentional failure to earn revenue otherwise available. As Ms. Winston testified, AOL now does include in-stream audio advertising in its broadband stations, Winston WRT ¶ 3; more important, because AOL was never in a sold-out situation for in-stream advertising, its failure to include ads in its broadband webcasts or XM stations did not cause it to sacrifice advertising revenue. Winston WRT ¶ 5(b), (c). 11/6/06 Tr. 18:7-19:20, 26:10-28:5 (Winston). Furthermore, as Ms. Winston also testified, Dr. Brynjolffson overlooks the primary motivation for including XM stations on the AOL service: that XM pays the excessive royalty costs for those stations. Winston WRT ¶ 5(c); 6/15/06 Tr. 154-55 (Winston). See Joint PFFCL ¶ 229 and fn. 27.[12]

F. DiMA Member Testimony Makes Clear That Video Pre-roll or "Gateway" Advertising Is a Pipe Dream/Webcasters not Leaving Ad Revenue on the Table

71. In ¶ 677, SoundExchange discusses the use of video pre-roll or "gateway" ads before audio streams begin. Later, at ¶ 806, they fault AOL and Yahoo! for not running such ads (despite the fact that Yahoo! runs such ads in its video player). As the record makes clear, however, neither Yahoo! nor AOL, the two largest webcasters in the market, sell video gateway ads because the demand for such ads on an audio product is so

[12] SoundExchange similarly ignores Ms. Winston's rebuttal testimony when it suggests, at ¶ 819 (citing Dr. Brynjolfsson's testimony from March 2006), that AOL does not attribute any revenue from its broadband subscribers to it webcasting service. As Ms. Winston's rebuttal statement makes clear, AOL has now decided to make its broadband radio product available for free (as opposed to part of a subscription package), and has added in-stream advertisements to that product – which moots entirely the suggestion that AOL "believes that revenue from subscribers to its broadband service should not be counted against a percentage-of-revenue fee." SX PFF ¶ 819. (SoundExchange's quotation from page 168 of Ms. Winston's testimony is just wrong – she was talking there about AOL's narrowband radio product, which has always had advertisements.)

slight. As Christine Winston of AOL testified, "it's difficult to know whether a video gateway ad would even work in an audio experience. People are launching a radio player to listen, and . . . they go on to do other things, it's not a visual medium. So, it's not clear how much advertiser demand there would necessarily be for that product." 6/15/06 Tr. 81:8-14; see also 6/15/06 Tr. 199:3-10 (Winston), 195:11-196:3 ("[V]ideo ads might not be as attractive to an advertiser to purchase in a primarily audio experience, since the primary behavior for someone listening to radio is to fire up the player, pick the station they want, and then do something else. So, if you are showing video ads, they are unlikely to see them or to pay attention to them, unlike when you show a video ad in front of a video, as we showed in the demonstration, the person is sitting there waiting for something visual to come up on screen that they want to see. So, they are going to wait through that commercial.").

72. Similarly, Mr. Roback of Yahoo! testified that the "market demand for such advertising" in the webcasting player is "minimal" because users tend to minimize the player immediately before having the chance to view a video-based advertisement (as opposed to video players where viewers have to continue watching the video player in anticipation of viewing their selected video). Roback WRT at ¶ 13(c) and fn. 6. Dr. Brynjolfsson's calculation of per-hour revenues for video ads, which he claims proves how lucrative they can be, see SX PFFCL ¶ 806, simply underscores Mr. Roback's observations that the video experience and market is vastly different (and more valuable to advertisers) than the webcasting market.

73. Even David Porter of Live365, which actually does attempt to sell such ads, testified that the sell-out rates are "unfortunately quite low," and that the CPM tops out in the $10-15 range for those few that are sold – putting the lie to Professor Brynjolfsson's claim that such ads are "lucrative," and his use of $20-$26 for these advertisements in his model, with an assumed sell-out rate of 90%. 6/19/06 Tr. 42:9-22 (Porter); Brynjolfsson WDT Appendix A "Advertising" Tab at 1, lines 13, 16.

G. SoundExchange Has Adduced No Evidence of Ad Targeting

74. SoundExchange suggests in ¶ 674, and later in ¶¶ 836-837, 839, that webcasters can "increase the value of webcasting" by narrowly targeting advertisements to particular listeners. SoundExchange adduced no evidence, however, of the degree to which such targeting is being used (if at all), the value of such targeting to advertisers, or prices charged for it by webcasters. The only Internet-only webcaster to discuss the use of such targeting, David Porter of Live365, noted that they gather registration data from users only after the 15th listening session, and that they "hope that that information can be used to target advertising, even though that hasn't been interesting to date." 6/19/06 Tr. 115:13-116:1 (Porter) (emphasis added).

H. Miscellaneous

75. At ¶ 781, SoundExchange quotes a research study conducted by AOL in which AOL's radio product ranked high in popularity compared to other content among the limited audience of AOL broadband subscribers. Ms. Winston's testimony made clear that the survey was done by demonstrating types of content to survey recipients and then asking questions about it – i.e., the respondents weren't necessarily even users of the

product. 6/15/06 Tr. at 1768:177:1 (Winston). Ms. Winston also explained that the survey did not include other aspects of the AOL subscription package that people value much more than proprietary content: an Internet connection, speed and reliability of connection, email service, etc. Id. at 179:5-19. In fact, when AOL conducted a more comprehensive study – the "10x" study – that did include over 180 features offered as a part of an AOL subscription, including non-content features but the "basics of the ISP relationship," it discovered that content in general "fell to the bottom of the list." Id. at 241:3-11. This research precipitated AOL's decision to make its content available for free, given that it "wasn't adding any particular value" to the value of the AOL subscription. Id. at 242:3-11, 245:22-246:20, 249:17-250:4; see also Svcs. Dir. Ex. 166 at 8 (showing that no content fell into top 20 rated features), 16 ("Content Features Were Not Core Value Drivers for the AOL or Non-AOL Audiences"); 6/15/06 Tr. 248:17-22 (noting that among most subscribers, radio ranked at about 100 out of 180 features in terms of popularity).

76. SoundExchange's attempts to attack the credibility of DiMA witnesses are unwarranted, and deserve only a brief reply. At ¶ 847, SoundExchange faults Mr. Roback for "not knowing much" about how much of a loss figure that was provided in his written testimony related to webcasting losses. Putting aside the frequent examples of SoundExchange's record company witnesses "not knowing much" about contracts they themselves sponsored as exhibits, the fact is that Yahoo! has represented from the beginning that it does not break out its costs specific to its webcasting product in its usual course of business. Moreover, in his rebuttal testimony, Mr. Roback endeavored to

provide a full explanation of the exhibit at issue and what was and was not included – a fact overlooked by SoundExchange. See Roback WDT ¶ 19. Furthermore, the fact that Yahoo! Music has no control over certain overhead costs attributed to it by Yahoo! (and Mr. Roback's belief that they are sometimes too high) is, despite SoundExchange's protestations in ¶ 847, irrelevant to the question of Mr. Roback's credibility.

VIII. WIRELESS AND PORTABILITY

77. In Section VIII of its Proposed PFFCL of Fact, SoundExchange claims that "record companies are paid more for sound recordings that are to be made available over wireless networks to consumers." SX PFF ¶ 870. A careful reading of the record, however, reveals that this so-called "portability premium" is unfounded. SoundExchange attempts to hide the clear implications of the record by creating a false distinction between "wireless" and "wired" markets. At the same time, they obfuscate the only real distinction reflected in the record and in the marketplace – that between content distributed over the Internet generally (the vast bulk of cases) and the occasional use of content distributed via private proprietary networks.

78. DiMA refers to and incorporates herein Section IV.A from its prior Proposed Findings of Fact regarding the Portability Premium.

B. SoundExchange Mischaracterizes the Fundamental Distinctions Regarding Portability

79. SoundExchange claims that DiMA has "ignored" the supposedly distinct service they term "wireless webcasting." SX PFF ¶ 872. Their witnesses argue that consumers are willing to pay more for this "wireless webcasting" and that, in turn, they

should receive a premium royalty for content streamed wirelessly. Id. at ¶ 871. The record established in this proceeding, however, draws a different and more subtle distinction. In the overwhelming majority of situations, consumers do not pay more, as SoundExchange alleges, based upon whether they are accessing content "tethered to the personal computer" or via a wireless device. SX PFF ¶ 878. As the record shows, in the exceedingly rare case that consumers are charged different amounts based upon whether content is accessed via the Internet generally, it is only when that content is being accessed via a proprietary digital network. See, e.g., DiMA PFFCL ¶¶ 61-64.

80. SoundExchange offers a paucity of evidence supporting their position that consumers are willing to pay more for streamed music because it is delivered wirelessly. The label witnesses do not cite any data or studies to support their contentions that consumers place a greater value on webcasts streamed wirelessly, but instead rely only on their own "intuitions." DiMA PFFCL ¶ 68. SoundExchange refers vaguely to its own licensing practices. SX PFF ¶¶ 903-906. However, the precious few deals SoundExchange refers to specifically are either for dramatically different services (*i.e.*, video, mastertones, and conditional downloads) or are delivered via proprietary digital networks (*e.g.*, Sirius and Rhapsody on the Sprint mobile network, Mspot Music Radio, Mobzilla). See SX PFF ¶¶ 887, 899.

81. DiMA members deliver DMCA-compliant radio via the Internet. See, e.g., Roback WDT ¶ 1; Winston WDT ¶¶ 4-5. Once connected to the Internet, a consumer can access content from a variety of providers. For example, a consumer might choose to

read a Thomas Friedman editorial on NYTimes.com, or purchase a song off of the iTunes Store, or listen to a webcasting stream from Yahoo! or AOL. See DiMA PFFCL ¶ 63.

82. As SoundExchange notes, this kind of general connection to the Internet is often established from a desktop computer that is "tethered" by a physical wired Internet connection. SX PFF ¶ 878. But this type of general connection to the Internet can also be established via wireless networks by mobile devices – *e.g.*, via laptops or other wireless devices that conform to the general Internet protocols and over private or public wireless Internet networks, often referred to as "WiFi" networks. DiMA PFFCL ¶ 61. SoundExchange attempts to lump these WiFi networks in with other, much less common, proprietary digital networks (see, e.g., SX PFF ¶ 878), but this conflates distinct technologies which have different implications for the delivery of streaming digital radio.

83. SoundExchange does not cite any example where a content provider charges an extra "portability premium" for accessing content wirelessly via a WiFi network. DiMA PFFCL ¶ 62. Indeed, the record shows just the opposite: consumers do not pay a different fee for accessing content over a general connection to the Internet, regardless of whether that connection is established via WiFi, Cable modem, DSL, or dial-up connection; Tom Friedman's editorials cost the same whether one gets them at home, on a paid wireless connection at a Starbucks, over a WiFi "hotspot" at the local library, on a desktop, on a laptop with a wireless card, or on any other device capable of communicating via standard Internet protocols. Id. at ¶ 63.

84. The non-discriminatory nature of content delivery over all kinds of connections to the Internet holds true in the case of webcasting. As Robert Roback of

Yahoo! Music testified: "LaunchCast is an Internet radio application – to the extent you can access the Internet from anywhere, you would have unlimited access to it and there's no prohibition in the contract with Universal or premium paid to be able to do that." 11/9/06 Tr. 31:18-32:1 (Roback).

85. The most the evidence establishes – which appears meaningless in the present context – is that proprietary digital networks, *e.g.*, mobile phone services and satellite radio providers, do charge fees for access to (and occasionally for services provided over) those networks. See, e.g., DiMA PFFCL ¶ 73; SX PFF ¶¶ 882-83 (noting the growth of mobile data over proprietary mobile networks).

86. This distinction between general access to the Internet (wired or wireless) and access to proprietary digital networks (again, wired or wireless) is born out by SoundExchange's own Proposed PFFCL of Fact: SONY BMG claims its agreements [redacted] SX PFF ¶ 907. Although other SoundExchange members testified that they charge different rates for delivery to a "portable" device as opposed to delivery over a "fixed-line," see, e.g., SX PFF ¶ 903-07, this distinction is not borne out by the evidence or common sense.

87. Eisenberg claims that record companies "always get premiums for . . . wireless or portable functionality." SX PFF ¶ 901. This assertion, repeatedly made by SoundExchange, is flatly contradicted by the evidence: First, as discussed above, there is no premium charged when a consumer accesses a DiMA member's DMCA-compliant webcast over a wireless internet connection. Second, "portable functionality" has been a

feature of music consumption for decades without any premium being paid to the labels – e.g., on portable radios, CDs, and portable MP3 players. 5/11/06 Tr. 246:9-247:16 (Eisenberg). Despite the marked increase in music portability due to the advent of MP3s and iPods, [prices for CDs "have come down."] 5/11/06 Tr. 247:7-247:16 (Eisenberg). Finally, SoundExchange's attempt to lump together portability and wireless connectivity as if they are equivalents mischaracterizes the record. iPods are by far the most popular portable music player today, with over 40 million units sold – but iPods do not, and never have, had the capability of playing live webcasts. 5/11/06 Tr. 376:14-377:9 (Eisenberg). Similarly, although there are millions of mobile phones on the market today, a meager percentage are capable of accessing even the proprietary streaming music services that some phone providers offer. 5/11/06 Tr. 379:21-379:18 (Eisenberg). There is no evidence that the DiMA members internet webcasts are available via mobile phones or via any other mobile device, other than those – such as laptop computers – that are capable of connecting to the internet generally. See DiMA PFFCL ¶ 67.

88. SoundExchange has not established that consumers are paying a higher price for portability itself in any significant way.[13] Outside the digital context, consumers have listened to music on portable devices for decades and have never been charged any special fee for portability. DiMA PFFCL ¶ 71. Similarly, when consumers

[13] One service where SoundExchange does charge a premium for portability is in the context of tethered/conditional downloads, where consumers can download or stream on-demand a copy of a particular song to their desktop for one price, and can then copy that song to a portable device for an additional fee. However, such services are the polar opposites of webcasting in terms of their substitutional effect and high interactivity. Also, in such a service, consumers in fact pay extra to make an *extra copy* onto a portable device. DiMA PFFCL ¶ 72.

access content over a general connection to the Internet, they pay the same price whether that content is sent to them over a wire or wirelessly. The rate for delivering DMCA-compliant webcasts via an Internet connection, over standard Internet protocols, should not be any different simply because it is being transferred with or without wires.

C. SoundExchange Members Do Not Assume Any Additional Risks or Costs that Would Justify a Premium Rate For Webcasting Delivered via the Internet Over Wireless Networks

89. The sound recording rightsholders offer no justification for receiving any such "portability premium." First, they bear no additional cost when a webcasting stream is provided to a consumer's laptop over the Internet on a WiFi network than they do when that same stream is transmitted to that same consumer's desktop over a fixed line. DiMA PFFCL ¶ 64. Rather, it is the Internet Service Providers, municipalities, and business sponsors who have invested significant resources into building and maintaining such WiFi networks. 11/22/06 144:13-145:22 (Griffin).

90. SoundExchange claims that increased consumer access to webcasting through wireless Internet connections increases the substitutional risks associated with webcasting. SX PFF ¶ 908. SoundExchange simply has not presented any evidence to support this assertion. DiMA PFFCL ¶ 68.

91. There *is* evidence, however, that DMCA-compliant webcasting most closely substitutes for and competes against terrestrial radio (the original "wireless" technology), where record companies receive *no* compensation from the performance of sound recordings. Joint PFFCL ¶¶ 139, 268; 6/7/06 Tr. 78:14-80:4 (Kenswil). To the extent that webcasting supplants terrestrial radio, access to webcasting through WiFi

connections would already result in a net revenue gain for the sound recording rights holders. See DiMA PFFCL ¶ 73. In other words, the sound recording rightsholders are already the net beneficiaries of widely available wireless Internet connections: the more widely available Internet connections are, the more likely consumers are to spend time listening to webcasts. For SoundExchange, then, increased access to WiFi connections means potentially greater royalties without any additional expenditure. Id.

IX. PROMOTION AND SUBSTITUTION

92. DiMA refers to and incorporates herein Sections VII.A and VII.B from its prior Proposed Findings of Fact regarding the Promotion and Substitution.

A. SoundExchange Misinterprets the Applicable Statutory Criteria

93. SoundExchange attempts to confuse the law by asking the Board to apply a different criterion than the one required by statute. SoundExchange conveniently argues that while record companies *never* consider the possible promotional value that they may receive when negotiating voluntary agreements, they do consider the possible substitutional effects on CD sales. See SX PFF ¶¶ 924, 927, 979-986. Notwithstanding the evidence to the contrary demonstrating the record companies *do* consider promotional effect in negotiating deals,[14] the statutory mandate at 17 U.S.C. § 114(f)(2)(B) is that this Board "shall base its decision," in part, on promotional value considerations irrespective of whether record companies make it a factor in their negotiations. See Joint PCL II.B.1.

[14] See, e.g., Servs. Ex. 41 (internal Sony memorandum discussing one of the factors to be considered in negotiating rates for a catalog license is "Whether the effect of the service is substitutional or promotional.")

94. SoundExchange also argues that, absent some precise monetary quantification, this Board cannot factor in the promotional value webcasting provides to the music industry. See SX PFF ¶ 922. While it may be difficult to quantify with any precise dollar figure, the record is clear that webcasting does provide significant value, not only in the form of additional revenue from increased record sales,[15] see 11/27/06 Tr. 184:1-184:7 (Pelcovits); DiMA PFFCL ¶¶ 92, 94-96, but also in terms of revenues realized through more efficient spending of promotional dollars as a result of webcasting's "testing" function. See DiMA PFFCL ¶¶ 87-88. Moreover, as Dr. Jaffe's testimony makes clear, even if this net promotional value defies exact quantification, it necessarily weighs in favor of this Board setting a rate in the lower end of the acceptable range that he has proposed. See 6/28/06 Tr. at 56:11-59:10 (Jaffe); 11/8/06 Tr. at 64:9-65:3 (Jaffe).

B. Webcasting is Inherently Promotional

95. SoundExchange does not, and indeed cannot, refute the fundamental proposition that people do not buy music they have never heard. See DiMA PFFCL ¶ 78. By definition, a spin of a song that is heard by a listener who otherwise never would have heard that song is necessarily promotional, as it results in increased publicity and exposure for that song. Indeed, this is why radio broadcasts have traditionally been the

[15] SoundExchange attempts to diminish this value by arguing that sales through webcaster's "buy-buttons" are insignificant. However, as Dr. Pelcovits admits, this data does not reflect the true impact of webcasting's promotional value as it excludes sales conducted through other outlets, including the nation's leading download retailer, iTunes. See 11/27/06 Tr. 38:19-39:1, 177:22-174:16 (Pelcovits).

single most important factor in driving the sale of sound recordings. See DiMA PFFCL ¶¶ 77-79.

96. SoundExchange argues that only comprehensive multi-media marketing campaigns aimed at a "handful of tracks" can be termed "promotional."[16] See SX PFF ¶¶ 924, 959-964, 976-978, 980. Surely, however, even accepting the proposition that webcasting is not what the SoundExchange witnesses consider the *most* effective form of promotion does not mean that it has no promotional value at all. Merely because promotions that are controlled by the record label are viewed by the record label as more effective does not obviate the promotional value of webcasting, for which there is ample support in the record.[17] See DiMA PFFCL ¶¶ 93-96; Broadcaster's PFFCL ¶¶ 43-83. Webcasting provides tremendous promotional benefits to new and emerging artists in particular by providing these artists (and their labels) with increased access to listeners who otherwise might never have heard their music.

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[16] In its PFFCL, SoundExchange consistently ascribes a particularly narrow recording–industry-specific meaning to the term "promotion" so that they can argue that "promotions" only apply to a handful of artists. It is clear, however, from the use of the word "promote" in 17 U.S.C. § 114(f)(2)(B) that no such meaning was intended.

[17] SoundExchange engages in semantic games to argue that there is no justification for an across-the-board discount in the royalty rate because the "promotion" as they attempt to define it applies only to a handful of artists. See SX PFF ¶¶ 924, 937-939, 958. But it is *precisely* this aspect of webcasting, the ability to play thousands of artists who might not otherwise be played, that justifies an across the board decrease. As SoundExchange is so fond of pointing out, webcasts provide increased exposure to artists in genres across the board, from celtic music to baroque era classical. See Griffin WDT at 17; SX PFF ¶ 997.

97. Despite SoundExchange's efforts to downplay the positive promotional benefits conferred by webcasting, as well as terrestrial radio, see SX PFF ¶¶ 959-96418, the record demonstrates that promotional personnel from the major record labels recognize this value as they consistently reach out to webcasters to push for increased airplay and, in addition, to thank webcasters when they are successful in those efforts. See DiMA PFFCL ¶¶ 80-83; Broadcasters PFFCL ¶¶ 43-83.

98. SoundExchange claims that there is no evidence that individuals discover new music through webcasting. See SX PFF ¶¶ 961-962. The record reveals numerous examples, however, of individual listeners, as well as record company personnel, attributing the discovery of particular artists to webcasting. See, e.g., Frank WRT Ex. 17 ("I'm getting your CD today! I heard your music on Launch and I couldn't believe how refreshing it sounds."); Frank WRT Ex. 18 ("Just wanted to keep telling you guys that over 80% of all emails that come in to bonnie's [*sic*] site say they heard about her through launch. thanks SO much for your early support!"); Frank WRT Ex. 20 ("we were thrilled by the Launch airplay increase and sure this helped"); see generally DiMA PFFCL ¶¶ 94-96.

99. Moreover, the record shows that webcasting is especially effective in exposing listeners to new artists who have a harder time getting airplay on the

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[18] Because of the obvious similarities between airplay over the Internet and terrestrial radio, SoundExchange attempts to downplay the promotional value of all airplay. See SX PFF ¶ 959. This claim appears to have little basis in fact as SoundExchange's own witnesses repeatedly have acknowledged the value of radio airplay, see Radio Broadcasters' PFFCL ¶¶ 54-68 (not to mention the New York State Attorney's on-going investigation into alleged payments made by various record labels to radio stations for increased airplay, see 6/7/06 Tr. 195:2-196:1 (Kenswil)).

increasingly narrow formats of terrestrial radio. See DiMA PFFCL ¶¶ 84, 96. To the extent that webcasting exposes listeners to new artists and deeper, back-catalog tracks, which would never find their way to terrestrial radio in today's market, it can only result in increased profits for the record labels. This is especially significant given the recognition that the majority of digital download sales on iTunes (the download market leader) consists of back catalog material. See 11/30/06 Tr. 190:1-191:2 (Eisenberg).

100. Additionally, SoundExchange ignores the fact that the record labels derive significant additional value from the testing function provided by webcasting. See DiMA PFFCL ¶¶ 87-88. Webcasters such as AOL and Yahoo! provide detailed listener data to record labels which, in turn, use this data to spend their limited promotional dollars in the most cost-effective manner. See DiMA PFFCL ¶ 89.

B. Webcasting Does Not Substitute for CD Sales

1. There is No Evidence to Support SoundExchange's Narrowcasting Theory

101. SoundExchange starts from the rather unremarkable proposition that "users are likely able to find stations that play music to which they enjoy listening," and ends up with the untenable conclusion that "preprogrammed radio competes with other products, like CDs, for time spent by consumers experiencing music." See SX PFF ¶¶, 992, 994. This leap in logic is premised on the notion that consumption of any music-related offering must necessarily displace consumption of another due to the inherent limitations of time. See SX PFF ¶ 989. This tautology collapses under the weight of its own absurdity as any daily activity, be it listening to webcasting, watching TV, walking the dog or playing with one's kids, would necessarily be viewed by the recording

industry as substituting for music consumption, and therefore deserving of some form of payment.[19] Additionally, nowhere does SoundExchange explain how it is that listening to a webcast instead of an already purchased CD or download substitutes for the sale of a future sound recording. The evidence adduced in section VII.A.4 of DiMA's PFFCL suggests the exact opposite effect.

102. Sound Exchange would have the Judges believe that the increased availability of musical outlets provided by webcasting is a net negative for the sound recording industry despite the fact that none of its witnesses could point to any data in support of their narrowcasting theory.[20] See DiMA PFFCL ¶ 86; see also 6/5/06 Tr. 95:11-96:6 (Bryan). To the contrary, the vast majority of evidence in the record supports the opposite conclusion. It is precisely because listeners can find stations more suited to their particular tastes that the delivery of heretofore unknown music is more likely to result in the sale of a sound recording. DiMA PFFCL ¶ 85.

103. SoundExchange's claim that the search functionality offered by the DiMA webcasters turns webcasting into an interactive experience is highly misleading. The

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[19] Additionally, as Mr. Griffin himself admits, at-work listening to webcasting very well may be *new* listening – i.e., it may not be the case that the pie of listening time is fixed, but rather that webcasting adds to listening time (and royalties) where AM/FM listening was not before possible. 11/22/06 Tr. 123:20-124:7, 135:22-136:12 (Griffin). Moreover, to the extent that an individual listener tunes into webcasting as opposed to terrestrial radio in their office, for example, it represents a net benefit to the record companies in the form of new royalties. See 11/22/06 Tr. 135:9-136:12 (Griffin); 5/3/06 Tr. 27:3-29:10 (Griffin).

[20] SoundExchange points to Mr. Iglauer's fears that "customer may choose to listen to these services instead of buying Alligator's blues recordings." However, given that Mr. Iglauer's own website streams *actual* Alligator sound recordings, it appears this fear is misplaced. See 5/18/06 Tr. 198:4-205:7 (Iglauer).

record is clear that none of the search functions offered by the DiMA webcasters permits users to search for particular songs or artists that are playing at any given moment.[21] See DiMA PFFCL ¶ 100; 5/2/06 Tr. 218:18-220:17 (Griffin). At best, these search functions only permit a user to select stations that have played a particular artist in the past or play similar types of music. See id. There is no evidence to suggest that the ability to find the kinds of music that one enjoys would satiate one's desire to listen to a particular song at a particular moment.

2. There is No Evidence to Suggest that the Availability of Streamripping Software Displaces Music Sales

104. Just like the RIAA did five years ago, SoundExchange conjures up the boogeyman of streamripping software to argue that DMCA-compliant webcasting should be subject to a higher compulsory rate. There is no evidence, however, which suggests that any significant number of individuals prefer to record random, pre-programmed songs, as opposed to easily obtaining the exact songs they want (either legally, or by downloading them illegally from a Peer-to-Peer network). See SX PFFCL IX.E.5.

105. SoundExchange states that "James Griffin included a recorded demonstration of how easy streamripping has become. (internal citations omitted). He ended up with a digital file that sounded like CD quality." See SX PFF ¶ 1017. Of course Mr. Griffin's "rip" didn't just *sound* like CD quality, it *was* CD quality. That's because

[21] SoundExchange misleadingly points to Shoutcast as an example of a webcaster that allows a user to search for a channel that is playing a particular artist at a given moment. As Mr. Griffin's testimony made clear, however, it is far from clear that Shoutcast is actually a DMCA-compliant product offering subject to this proceeding. See DiMA PFFCL ¶ 100; 5/2/06 Tr. 218:18-220:17 (Griffin).

Mr. Griffin chose to demonstrate his streamripping prowess on what was actually *an on-demand download service* known as Rhapsody, which provides on-demand downloads of CD quality recordings. See 5/2/06 Tr. 267:20-268:16 (Griffin). Had Mr. Griffin actually attempted to streamrip that same David Gray song off of one of the non-interactive, DMCA-compliant webcasts that are subject to this proceeding, he might still be waiting for it today (and surely would not have any way to know when it might air).[22] See 5/2/06 Tr. 270:9-270:17 (Griffin).

106. In fact, SoundExchange's entire section on streamripping is riddled with half-truths:

- "This type of software. . .breaks streams into individual sound recordings, identifies each sound recording, and tags the sound recording with artist's name, song, and album title." See SX PFF ¶ 1019. While some certainly have this feature, Mr. Griffin admitted that a "great many" do not. See 5/3/06 Tr. 191:4-191:10 (Griffin); see also DiMA PFFCL ¶ 99.

- "Streamripping software is targeted by makers to users of webcasting and is in wide use." See SX PFF ¶ 1021. The reality is that there is no data suggesting how many people have actually purchased such software, rather than merely downloading the free, limited trial version. Nor is there any data which suggests individuals use such software to record webcasts as opposed to anything else coming over a sound-card. See DiMA PFFCL ¶ 99.

- "As advertised by streamripping software companies, users of streamripping software download 3000 songs in a single day." See SE PFF ¶ 1022. First, this was an advertisement for one particular piece of software. Second, it stated that "many users on broadband connections report downloading 3,000 plus songs a day" and even Mr. Griffin himself admitted he had no idea whether any users were actually able to do this. See 5/3/06 Tr. 311:12-312:14 (Griffin).

[22] This is because it is impossible to search for a particular song on any of the DiMA members webcasts. See DiMa PFFCL ¶ 100.

107. The only thing SoundExchange has proven is that such technology exists. The same was true when Mr. Griffin first raised the spectre of streamripping in the last CARP and five years later, there is still not a single study which suggests it has displaced a single music sale. This is because today, like then, an individual desiring to steal music would be much more likely to use a popular P2P site such as Kazaa, where he or she can download a CD-quality copy of the exact song he or she wants, at the exact moment he or she wants it, and for free. See DiMA PFFCL ¶ 101. SoundExchange's streamripping argument simply has no basis.

X. THE ROLES OF THE RECORD COMPANIES AND RECORDING ARTISTS IN THE CREATION OF THE COPYRIGHTED WORK

108. The relative contributions of the respective industries are discussed in DiMA's PFFCL at Section VII.C. There is no dispute that record labels spend large amounts of money creating sound recordings. See SX PFF Section X. There is also no dispute that the record companies make hundreds of millions of dollars in profits from selling these sound recordings in the form of albums, CDs, and digital downloads, and have been so profiting for many years – circumstances that speak volumes about the so-called "risks" faced by the record business. See, e.g., Svcs. Ex. 118 at 28 (2005 Warner Music Group 10-K submission to SEC indicating Recorded Music revenues of over $2.9 billion, OIBDA (operating income before depreciation and amortization) of $380 million, and net operating income of $215 million). Nor is there any dispute that the record labels contribute nothing but pre-existing copyrighted works to webcasting services and incur no costs specifically attributable to these services. See DiMA PFFCL ¶ 116 (citing similar testimony from record-company witnesses Kushner, Iglauer, and Ciongoli).

109. As expected, SoundExchange has therefore placed all of its focus on a factor irrelevant to the "relative contribution" consideration: the record companies' contributions, costs, and risks involved with the creation of the copyrighted works in the first instance. See SX PFF ¶ 1040. SoundExchange also baselessly seeks to diminish the role of webcasters in the webcasting process by asserting that webcasting businesses are founded entirely on the backs of artists and record companies – supplying only their own witnesses' conjecture as support for this remarkable proposition. See SX PFF ¶ 1053. In so doing, they essentially attempt to shirk Section 114(f)(2)(B)(ii)'s requirement that the Judges compare the parties' relative contributions, investments, costs, and risk associated with the creation of copyrighted sound recordings and the provision of webcasting services to the public in favor of a creation-of-copyrighted-works-only standard. See Joint PFFCL II.B.2 (PCL); DiMA PFFCL II.B.2; SX PFF ¶ 1039.

110. Given that none of SoundExchange's contributions, costs, and risks is in any way directed at the webcasting market contemplated by section 114, see DiMA PFFCL para. 116, the Judges should determine that webcasters' contributions, costs, and risks far outweigh those of copyright owners under the comparative analysis established by Section 114(f)(2)(B)(ii).

111. Unlike DiMA, which presents the contributions, costs, and risks faced by each of its participating members, SoundExchange fails to point to any evidence showing a single copyright owner who faces aggregate costs and/or risks anywhere near those faced by participating DiMA members. See DiMA PFFCL VII.C. Instead, SoundExchange's proposed findings cobble together the creative contributions of, and

risks borne by, independent artists with the capital expenditures of major record companies (many completely irrelevant) in an effort to create a confusing and theoretical conglomerate that makes contributions and bears risks on par with those made and borne by webcasters in the field of webcasting. See SX PFF X. The bottom line, however, is that even taken at face value, these are certainly not webcasting-related costs and risks (and, in the case of major record companies, not risks at all); hence the Judges should find that DiMA members' relative contributions, costs, and risk weigh in favor of a lower rate.

112. SoundExchange admits that the record companies make no creative contributions to sound recordings, see Id. paras. 1041-51, instead citing to the artwork and packaging (not sound recordings) of artists' CDs as the lone examples of areas in which the record companies work creatively alongside artists, see Id. paras. 1052, 1073.

113. Similarly, SoundExchange seeks to cast the risks borne by struggling, independent artists as those borne by the recording industry writ large, see id. X.B.1, citing to testimony that these independent artists don't enjoy the "advances, tour support, publicity or marketing" that artists on major labels enjoy, see Id. para. 1055.

114. More important, many of the costs cited by SoundExchange as indicative of record companies' capital expenditures occur after the creation of the copyrighted work[23] and are therefore irrelevant to even the most lenient comparative analysis that

[23] SoundExchange will argue that all of the costs faced by record labels are cyclically involved in the creation of copyrighted work. The more appropriate view, however, is that all of these costs are cyclically involved in the generation of revenue in established markets completely unrelated to webcasting – a view supported by the fact that most

might be conducted under section 114(f)(2)(B)(ii). See Services Joint Conclusions II.B.2; DiMA Conclusions II.B.2; see also SX PFF ¶ 1039.

- Manufacturing and distribution costs related to producing and distributing physical CDs are irrelevant to an analysis of the contributions related to the creation of a copyrighted work – the moment the recording, mixing, and mastering are complete, a copyrighted work exists. See SX PFF X.B.2.a.
- Similarly, advertising and promotional costs have nothing to do with the creation of copyrighted works in the first instance, and certainly nothing to do with subsequent performances via webcasting. As their name suggests, they relate to the advertising and promotion of existing copyrighted works (again for the purpose of driving CD and download sales). See id. X.B.2.c.
- By definition, overhead costs are broad and relate to many activities that fall outside the scope of the creation of copyrighted works. See id. X.B.2.d.
- Mechanical royalty costs paid to print millions of copies of CDs for retail sale likewise cannot be considered part of creating the initial copyrighted sound recording. See id. X.B.2.e.
- Lastly, costs related to the digital distribution of sound recordings lack any relationship to the creation that copyrighted work – the same way that physical distribution of an existing copyrighted sound recording bears no relationship to its creation. See id. X.B.2.f.

XI. EPHEMERAL COPIES

115. SoundExchange proposed a separate rate for the right to make ephemeral copies under 17 U.S.C. § 112. DiMA agrees with SoundExchange that whatever rate the Judges set for the Section 114 performance royalty, be it a percentage-of-revenue metric

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capital expenditures cited by SoundExchange as part of its argument in no way relate to the creation of a copyrighted sound recording. This cycle and these established markets generate tremendous profits that more than offset any risk associated with the creation of copyrighted works as it is practiced by the major labels – a fact that militates against the record companies under the comparative analysis required by section 114(f)(2)(B)(ii). See, e.g., Svcs. Ex. 118 at 28 (2005 Warner 10-K submission to SEC indicating billions in revenue and hundreds of millions in profits).

or per-use metric, that the fee should be deemed to *include* the fee for ephemeral copies (i.e., there would be no separate, additional fee for the ephemeral copies). This is consistent with the regulations adopted by the Copyright Office in 2004. See 37 C.F.R. § 262.3(c).

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CERTIFICATE OF SERVICE

I hereby certify that copies of the REPLY OF THE DIGITAL MEDIA ASSOCIATION AND ITS MEMBER COMPANIES TO SOUNDEXCHANGE'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW OF were served on December 18, 2006 by overnight mail on the following parties:

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